Issues in Business Valuation for SBA Lenders

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Topics

Section I – Current SBA Business Valuation Requirements

Section II – Business Valuation Engagements

Section III – Typical Valuation Process

Section IV – Business Valuation Review

Section V – Goodwill, Valuation & the SBA

Section VI – Questions and Answers

I. Business Valuation Requirements

A. Business Valuation Requirements – Page 185 & 186

"Determining the value of a business is the key component to the analysis of any loan application for a change of ownership. An accurate business valuation is required because the change in ownership will result in new debt unrelated to business operations and create an intangible asset. A business valuation assists the buyer in making a determination that the seller's asking price is supported by historic operations and permits the buyer to make a reasonable return on his or her investment."

"If the amount being financed minus the appraised value of real estate and/or equipment is greater than $250,000 or if there is a close relationship between the buyer and seller, the lender must obtain an independent business valuation from a qualified source."

- If amount is $250,000 or below, the lender may do their own internal business valuation.

B. Qualified Source – Page 186

"A qualified source is an individual who regularly receives compensation for business valuations and is either:

(1) Accredited by a recognized organization; or
(2) A licensed CPA that performs the business valuation in accordance with the SSVS published by the AICPA.
(3) Some recognized organizations and the accreditations they provide include:

(a) Accredited Senior Appraiser (ASA) accredited through the American Society of Appraisers;
(b) Certified Business Appraiser (CBA) accredited through the Institute of Business Appraisers;
(c) Accredited in Business Valuation (ABV) accredited through the AICPA;
(d) Certified Valuation Analyst (CVA) accredited through NACVA.

C. Scope of Work – Page 186

"In order for the individual performing the business valuation to identify the scope of work appropriately, the business valuation must be requested by and prepared for the lender. **The business valuation must include the individual's opinion of value, the qualifications of the individual performing the valuation and their signature certifying to the information contained in the valuation.** The cost of the valuation may be passed on to the Small Business Applicant."

- Engaged by lender;
- Prepared for lender;
- Include qualifications of the individual performing the valuation;
- Signature with certification page.

D. Valuation as Part of Closing – Page 187

"If at time of closing the business valuation:

(a) Comes in at 90% or more of the estimated value, the lender may close the loan but must include a written explanation as to why the business valuation is less than the estimated value in the loan file; or

(b) Comes in less than 90% of estimated value, the lender may not close the loan without the SBA's prior written permission.

Exception for PLP Lenders. PLP lenders are permitted to close a loan when the business valuation is less than 90% of the estimated value but the lender must include a written justification as part of its file that may be reviewed by the SBA at time of guaranty purchase or when SBA is reviewing the lender. The justification must include a thorough analysis by the lender of the reasons for the business valuation being low and an explanation as to what steps the lender took to offset the risk from the low business valuation such as reducing the purchase price and/or loan amount or obtaining additional equity or collateral.

II. Business Valuation Engagements

A. Type & Scope of Valuation Engagement

Most appraisal organizations recognize two types of engagements:

(1) Valuation Engagement – The Valuation analyst expresses the results of the valuation as a conclusion of value.

(2) Calculation Engagement – Also known as a limited or "desktop" appraisal, the valuation analyst and the client agree on the valuation approaches and methods the valuation analyst will use and the extent of procedures the valuation analyst will perform in the process of calculating the value of a subject interest (these procedures will be more limited than those of a valuation engagement).

A calculation engagement does not include all of the procedures required for a valuation engagement. In MOST cases, the lender should choose a valuation engagement and conclusion of value NOT a limited or calculation engagement

B. Report Type

- All organizations recognize a "short form" report.
- Level of detail sometimes corresponds to loan risk, size, complexity, etc.
- Letter form vs summary vs comprehensive – which to choose?
- Regardless the type of report, must come to a conclusion of value.
- If "short form" report, appraiser must keep all supporting docs in workfile.

C. Fee Structure & Typical Cost

- Fixed or Hourly Fee?
- Should instruct appraiser to detail number of hours.
- Fee is sometimes based on demand / geography.
- Fees range from $2,000 to $20,000.
- Typical SBA engagement - $2,500 to $5,000.

III. Typical Valuation Process

A. Engagement (discuss, agree, retain, sign);
B. Information gathering (sometimes most tedious part);
C. Initial interviews, discussions with parties involved;
D. Analyze relevant financial data & descriptive information;
E. Identify relevant valuation methodologies;
F. Normalize income statements & balance sheets;
G. Estimate ongoing earning power;
H. Conduct industry/economic research;
I. Search for market comparables;
J. Conduct valuation analysis (asset, income & market approach);
K. Analyze any non-operating or excess assets;
L. Apply applicable discounts/premiums;
M. Reconciliation & conclusion of value;
N. Write report – (summary or comprehensive);
O. Finalize invoice, engagement & delivery method.

IV. How to Review a Business Valuation

A. SBA Requirement (change of ownership additional submission guidance)

- Was business appraisal compliant with USPAP & SOP50-10(5)(b)?
- Did business appraiser clarify / support cash flow & cap rate / multiple determination?
- Goodwill waiver request – reconciliation of value & page number, qualifications & signature.

B. Lender's Due Diligence

- Valuator should consider all 3 approaches to value – (1) Asset, (2) Market and (3) Income.

- Valuator should provide adequate industry, regional and national economic analysis and tell how it may or may not impact the value.

- Valuator should provide adequate information on company history and operations.

- Valuator should provide adequate financial analysis.

- Valuator should provide adequate discussion on methods considered, accepted and/or rejected and why.

- Valuator should provide and reasonably explain the valuation methodology and calculations.

- Valuation methodology should be "accepted" methodology and not based on rules of thumb.

- Valuator should provide explanation on final reconciliation of values.

V. SOP 50-10(5)(b) Changes - Goodwill

Policy. If Purchase Price includes intangible assets (now defined as goodwill) in excess of $500,000 then:

- Borrower and/or seller must provide an equity injection of at least 25% of the purchase price of the business to use delegated authority.
- Seller Equity = seller take back financing that is on full stand-by for at least 2 years.

Exception Policy. If the loan amount allocated to intangible assets exceeds $500,000, and there is less than 25% equity injection, loan must be submitted through the Loan Guaranty Processing Center (LGPC). No processing under delegated authority.

- If purchase price of a business includes less than $500,000 for intangibles, loans can be processed under delegated authority.

VI. Questions & Answers . . . We're Finished!

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